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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-890

GULF & WESTERN INDUSTRIES, INC.,

Cross-Petitioner,

v.

ALLIS-CHALMERS MANUFACTURING COMPANY,

Cross-Respondent.

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR CROSS-RESPONDENT IN OPPOSITION TO CROSS-PETITION FOR A WRIT OF CERTIORARI

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TABLE OF CONTENTS

	PAGE
Restatement of Question Presented	2
Restatement of the Case	2
The Decision of the District Court	4
The Decision of the Court of Appeals	6
Reasons for Denying the Writ	7
Conclusion	11

Table of Authorities

Blau v. *Lamb*, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967)	10
Blau v. *Lehman*, 368 U.S. 403 (1968)	9
Foremost-McKesson, Inc. v. *Provident Securities Co.*, Docket No. 74-742	1
Mueller v. *Korholz*, 449 F.2d 82 (7th Cir. 1971), *cert. denied*, 405 U.S. 922 (1972)	10
Newmark v. *R.K.O. General Corp.*, 425 F.2d 348 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970)	9-10
Park & Tilford, Inc. v. *Shulte*, 160 F.2d 984 (2d Cir.), *cert. denied*, 332 U.S. 761 (1947)	10
Reliance Electric Co. v. *Emerson Electric Co.*, 404 U.S. 418 (1972)	11
Stella v. *Graham-Paige Motors Corp.*, 259 F.2d 476 (2d Cir. 1958), *cert. denied*, 359 U.S. 914 (1959)	10

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On October 16, 1975 Allis-Chalmers Manufacturing Company ("Allis-Chalmers") filed a petition for a writ of certiorari (No. 75-580) requesting this Court to review the judgment of the United States Court of Appeals for the Seventh Circuit, which presented a question of the applicability of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), identical to the issue decided by this Court on January 13, 1976 in *Foremost-McKesson, Inc.* v. *Provident Securities Co.*, Docket No. 74-742. Gulf & Western Industries, Inc. ("Gulf & West-

ern'') filed a brief in opposition to Allis-Chalmers' petition. On January 19, 1976 this Court denied Allis-Chalmers' petition. Gulf & Western now requests this Court to review the judgment of the Court of Appeals as to but a single one of the components of the calculation of the amount of ''profit realized'' by Gulf & Western on its purchase and sale within six months of a 248,000 share block of Allis-Chalmers common stock as to which Gulf & Western's liability under Section 16(b) is not in issue. For the reasons set forth herein, Allis-Chalmers requests that this Court deny the cross-petition for a writ of certiorari.

Restatement of Question Presented

If a ''beneficial owner'' purchases and sells within six months securities in violation of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), can calculation of the amount of ''profit realized'' that the ''beneficial owner'' must disgorge be made by reference to the actual amount of dollars received by the insider or must such calculation of ''profit realized'' be made by reference to a hypothetical, substantially lower ''value''?

Restatement of the Case

The petition of Allis-Chalmers sets forth the essential facts underlying the two purchases and sale by Gulf & Western within six months of the listed securities of Allis-Chalmers. These facts will be repeated only to the extent necessary to respond to the single issue presented in Gulf & Western's cross-petition.

In July 1968, Gulf & Western purchased 3,000,000 shares of Allis-Chalmers common stock. This transaction resulted in Gulf & Western's acquisition of approximately 29% of the issued and outstanding shares of Allis-Chalmers.

In August 1968, Gulf & Western agreed that it would purchase 248,000 additional shares of Allis-Chalmers stock from The Oppenheimer Fund, Inc. Subsequent to this agreement to make this second acquisition of Allis-Chalmers stock, Gulf & Western, as a result of a conversation with Allis-Chalmers' chairman, became concerned over its substantial holdings of Allis-Chalmers stock. (Pet. App. at 4a + n.4.)*

On September 30, 1968, Gulf & Western closed the transaction for the purchase of the additional 248,000 shares of Allis-Chalmers stock from The Oppenheimer Fund, Inc., and, on that very same day, Gulf & Western commenced negotiations with White Consolidated Industries, Inc. (''White'') for the sale to White by Gulf & Western of its entire 3,248,000 shares of Allis-Chalmers common stock. Gulf & Western and White agreed that, in consideration for the 3,248,000 Allis-Chalmers shares, White would pay $113,680,000 plus an agreed upon amount of White securities. The purchase agreement specified that *White* had the *option* of delivering at the closing White securities plus either $113,680,000 in cash, or $20,000,000 in cash and a six-month promissory note in the aggregate principal amount of $93,680,000 bearing an annual interest rate of 8½%.**

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* Citations to "Pet. App. a" are to the Appendices to the petition previously filed by Allis-Chalmers, Docket No. 75-580.

** The agreement provided in pertinent part:

"In consideration of the mutual covenants contained herein, the parties hereto agree as follows:

1. G&W agrees to sell or cause to be sold to White and White agrees to purchase from G&W, at the Closing, all of the Shares, and G&W agrees to convey to White good and valid title to the shares, free and clear of any and all liens and encumbrances. In consideration therefor, White agrees to pay to G&W cash (in New York federal funds) in the aggregate amount of One Hundred Thirteen Million Six Hundred Eighty Thousand Dollars

On December 6, 1968, after indisputably having become a "beneficial owner" in July, 1968 and a scant two months after its purchase in September 1968 of the 248,000 shares of Allis-Chalmers stock from The Oppenheimer Fund, Gulf & Western closed the sale of its 3,248,000 shares of Allis-Chalmers common stock to White. In return for Gulf & Western's entire interest in Allis-Chalmers, White, exercising its option, paid Gulf & Western $20,000,000 in cash, 250,000 shares of White's unregistered common stock, and a six-month promissory note in the aggregate principal amount of $93,680,000 bearing interest at 8½% per annum (the "White note").

On March 20, 1969—two and a half months prior to the maturity of the note, three and a half months after the closing, and almost *four years* before the trial commenced in the District Court—White delivered to Gulf & Western a check in the amount of $95,948,852.56, representing prepayment of the full face value of the White note plus interest accrued to the date of prepayment.

The Decision of the District Court

The District Court held that Gulf & Western was a statutory insider for purposes of Section 16(b) with respect to profits "realized" by Gulf & Western on all 3,248,000 shares of Allis-Chalmers stock purchased and sold within six months. There was no dispute as to the proper measure of

($113,680,000) and to issue to G&W Two Hundred Fifty Thousand (250,000) shares of Common Stock of White (the "White Shares"). Notwithstanding the foregoing,

(a) *White may, at its option, deliver to G&W at the Closing its 8½%, six-month Promissory Note payable to G&W in an aggregate principal amount of not to exceed $93,680,000 (the "White Note") in lieu of delivering to G&W cash in an amount equal to such aggregate principal amount . . .*" (Emphasis supplied.)

profits—the difference between what Gulf & Western had paid for the 3,248,000 shares and what it had received on their sale within six months. There were, however, differences between the parties as to the valuation of components of the considerations Gulf & Western received and paid, the only one of which is involved in this cross-petition being the value of the White note. Allis-Chalmers took the position* that, for valuation purposes, the White note had to be valued at face value because Gulf & Western had actually received the entire $93,680,000 in cash shortly after the sale. Gulf & Western, however, argued that the White note had to be valued as of December 6, 1968 (the date of the closing), and offered evidence that the White note should be discounted for valuation purposes in determining the amount of profits realized by its violation of Section 16(b), despite the fact that Gulf & Western carried the White note at its full face value in all of its financial statements, in its contemporaneous filings with the Securities and Exchange Commission and the New York Stock Exchange, and in all of its communications with its stockholders. The District Court accepted Gulf & Western's contention and held that the White note, for purposes of computing profit realized, was worth only $88,996,000—a 5% discount—despite the fact that Gulf & Western actually received $93,680,000 (Pet. App. at 65a), plus interest in the amount of $2,268,852.56.

* At trial, Allis-Chalmers relied on the agreement between Gulf & Western and White, quoted in pertinent part above, and the fact of payment of the White note.

The Decision of the Court of Appeals

Allis-Chalmers appealed the computation of the amount of profit realized by Gulf & Western as to all 3,248,000 shares, including the District Court's valuation of the White note. The Court of Appeals reversed the District Court's ruling as to the valuation of the White note and modified the award of profits with respect to the 248,000 Allis-Chalmers shares Gulf & Western had purchased on September 30, 1968 and sold to White on December 6, 1968.* The Court of Appeals simply and logically held that if debt obligations such as the White note have been paid in full prior to trial, they must be valued at their full face amount in computing whether an insider who violated Section 16(b) has realized "any profit".

> "Given the broad remedial purpose of Section 16(b), its limited impact, and the intent of Congress in drafting this section to 'eradicate speculative abuses by reducing difficulties in proof', *Bershad* v. *McDonough*, 428 F.2d at 696, we hold that in transactions involving debt obligations of an amount certain, evidence of payment in full, if available at the time of trial, should control the determination of 'profit realized'. We cannot but wonder whether Gulf & Western's present belief that estimated market value at the time of closing is the only proper measure of 16(b) liability could have withstood the strains of a situation where White had in fact defaulted on the note completely. In any event, a rule of evaluation which looks to the realities in such situations will avoid the possibility that real profits will escape the reach of the statute or that non-existent profits will be 'recovered'. We believe this to be no more nor less than the language of the section requires." (Pet. App. at 33a-34a) (footnote omitted).

* The Court of Appeals reversed the holding of the District Court that Gulf & Western was liable to Allis-Chalmers for all the profits Gulf & Western had realized on the purchase and sale within six months of the initial 3,000,000 Allis-Chalmers shares, for the reason that Gulf & Western was exempt because it was not a "beneficial owner" under Section 16(b) prior to its purchase of approximately 29% of Allis-Chalmers common stock. The Court of Appeals specifically rejected Gulf & Western's claim that it was not a "beneficial owner" when it subsequently purchased the additional 248,000 Allis-Chalmers shares, and Gulf & Western does not dispute this holding.

Reasons for Denying the Writ

The cross-petition for a writ of certiorari should be denied for the reasons that the decision of the Court of Appeals does not conflict with any decision of this Court, or of any other court, and because the issue presented does not involve a recurring question of federal law.*

Gulf & Western unabashedly claims in its cross-petition that the Court of Appeals was wrong in holding that, in determining the amount of "profit realized" under Section 16(b), the Court should not have included in that calculation the actual amount of hard cash—$93,680,000—realized by Gulf & Western when White prepaid the full face value

* Gulf & Western's contention that the holding of the Court of Appeals "constitutes a plain circumvention of the mandate of Rule 52(a) F.R.C.P." (Cross-Pet. at 8) is frivolous on its face. As noted above, the Court of Appeals held *as a matter of law* that discounting a debt obligation in computing profit pursuant to Section 16(b) is improper when the obligation has in fact been paid in full prior to trial. The Court of Appeals did not overturn any finding of fact made by the District Court but merely held that any finding as to the value of the White note as of December 6, 1968 was irrelevant in determining the amount of "profit realized" because the White note had in fact (as found by the District Court) been paid in full prior to trial.

of the White note. Gulf & Western argues that the indisputed evidence of profits actually realized by it must be ignored, and that any determination of "profit realized" for purposes of Section 16(b) can only be made 1) as of the actual date the violative transaction took place and 2) by an estimate of value. (Cross-Pet. at 9.) In sum, Gulf & Western takes the position that "any profit" under Section 16(b) was not intended by Congress to mean "any profit". This approach urged by Gulf & Western is not supported by any legislative history, any court decision, or, we submit, any common sense.

The Court of Appeals held that because the evidence revealed precisely what Gulf & Western actually received as proceeds from the sale of its Allis-Chalmers stock to White, it was unnecessary to utilize either expert testimony or other market data to estimate a hypothetical value for the six-month promissory note. This holding, we submit, is entirely correct.

The Court of Appeals' determination of the actual profits realized was based upon the uncontroverted and unique facts of this case and involved a "rule of evaluation which looks to the realities in such situations". (Pet. App. at 34a.) Here, the seller gave the purchaser the option of either paying all cash or paying a portion in cash and the remainder in the form of a short-term promissory note. This short-term note was paid in full even prior to its maturity. The seller—Gulf & Western—received the full amount of cash it had bargained for shortly after the closing and, more importantly, almost *four years* prior to trial. It is highly unlikely that the situation presented with respect to the value of a debt security such as the White note will recur. In the forty-one year history of Section 16(b), this is the only case in which the issue has

arisen. Gulf & Western can cite no case under Section 16(b) involving actual payment of a debt security by the purchaser to the seller prior to trial. In any event, it is submitted that the Court of Appeals was correct in requiring Gulf & Western to disgorge as "profit realized" by it all actual profits rather than a hypothetically lower sum.

Gulf & Western suggests that the Court of Appeals is in "irreconcilable conflict" with this Court's decision in *Blau* v. *Lehman*, 368 U.S. 403 (1968), by "creating a fiction in holding that G&W must be treated as having received cash on the date of sale". (Cross-Pet. at 8, 12.) This Court in *Blau* v. *Lehman* held merely that a plaintiff could not recover as profits under Section 16(b) from a defendant director those sums received by the partnership of which he was also a partner when it was not shown that the director-partner had been "deputized" by the partnership or had otherwise acted in its behalf. 368 U.S. at 409-10. Here, where it is an uncontested record fact that Gulf & Western was actually paid the entire amount sought to be recovered as profits on the sale of its Allis-Chalmers stock, it would be little more than a fiction itself to exclude such sums from "any profit realized".

Nor is the Court of Appeals' holding as to the profits realized in this case contrary to rules used by other Courts of Appeals. The cases cited by cross-petitioner in support of its claim that the only proper measure of profit realized under Section 16(b) is the hypothetical value as of the date of purchase or sale (Cross-Pet. at 9; Pet. App. at 34a), involved, without exception, securities for which there was no other evidence available at the time of trial as to profits other than market data or evaluations of assets or securities based upon expert testimony. *See, e.g., Newmark* v. *R.K.O. General Corp.*, 425 F.2d 348, 356-58 (2d Cir.), *cert. denied,*

400 U.S. 854 (1970); *Stella* v. *Graham-Paige Motors Corp.*, 259 F.2d 476, 478 (2d Cir. 1958), *cert. denied*, 359 U.S. 914 (1959). *See also Mueller* v. *Korholz*, 449 F.2d 82, 86-87 (7th Cir. 1971), *cert. denied*, 405 U.S. 922 (1972) and *Blau* v. *Lamb*, 363 F.2d 507, 527 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967). None of those cases involved a short-term debt security the full face amount of which had been paid in full to the violator of Section 16(b). Unlike cases in which a court was faced with determining the Section 16(b) profits realized by valuing securities for which only expert or market data were available, this case involved the unusual situation of uncontroverted evidence of precisely what amount of money was actually received by Gulf & Western. To suggest, as does cross-petitioner, that "the actual value the [White] note produced for Gulf & Western" must be discounted by any amount whatsoever when the entire face value of the note was paid in full would permit Gulf & Western to retain a portion of those profits it actually realized on the sale of its Allis-Chalmers stock to White. (Pet. App. at 33a.) By looking to the "realities of this case", the rule the Court of Appeals applied to measure the actual "profit realized" by Gulf & Western "avoid[ed] the possibility that real profits will escape the reach of the statute or that non-existent profits will be recovered". (Pet. App. at 34a.) As the Court of Appeals for the Second Circuit observed in *Park & Tilford, Inc.* v. *Shulte*, 160 F.2d 984, 988 (2d Cir.), *cert. denied*, 332 U.S. 761 (1947):

> "Under the statute the amount recoverable by plaintiff is the receipts from the sale of the stock, minus the actual purchase price."

Section 16(b) was designed as a remedial statute. Congress attempted to discourage insider trading by taking

all of the profit out of a class of transactions in which the potential for abuse had been deemed present. The statute provides no flat prohibition on short-swing purchases and sales themselves but seeks only to render such transactions unprofitable. *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 422 (1972). To require Gulf & Western to disgorge *all* of the profits it actually realized as a result of its short-swing purchase and sale of 248,000 shares of Allis-Chalmers common stock, accords with the Congressional purpose and the express statutory language that "any profit realized . . . shall inure to and be recoverable by the issuer". To sanction any other rule in a case such as this would ignore both the plain language and the prophylactic purpose of Section 16(b). We submit that neither precedent nor logic supports the position urged by Gulf & Western.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the cross-petition for a writ of certiorari should be denied.

Dated: New York, New York
January 22, 1976

Respectfully submitted,

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